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SUPREME COURT, U.S.

No. 04-1566

In the Supreme Court of the United States

THEIS RESEARCH, INC.,

Petitioner,

v.

BROWN & BAIN
and such present and former Brown & Bain partners, associates, and other personnel responsible for the management and trial of all litigation involving Peter F. Theis and Theis Research, Inc.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONER'S SUPPLEMENTAL BRIEF

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QUESTIONS PRESENTED

1. Whether courts—as opposed to arbitrators—shall decide challenges to an underlying agreement with an arbitration clause on the ground that the agreement was void and never existed at the outset, in contrast to agreements that are merely voidable.

2. Whether, in a diversity case, state law can render an unlawful underlying agreement, including an arbitration clause and a resulting arbitration award, null and void *ab initio*.

3. Whether, for diversity jurisdiction to review an arbitration award, the amount in controversy is determined by the amount of the award or the amount in issue in the underlying dispute.

Rule 29.6 Statement: As stated in the petition, there is no parent or publicly held company owning 10% or more of the stock of petitioner Theis Research, Inc.

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INTRODUCTION

The supplemental brief submitted by respondent Brown & Bain (B&B) is based on a number of grossly erroneous assertions. Accordingly, petitioner Theis Research, Inc. (Theis) submits this supplemental brief in response.

This case is closely related to *Buckeye Check Cashing, Inc., v. Cardegna*, No. 04-1264. This case and *Buckeye* both raise the fundamental question of whether an arbitration clause is effective when embedded in a contract that is illegal under state law applicable to contracts generally. B&B does not dispute:

- that B&B had multiple conflicts of interest in the underlying patent litigation;
- that California conflict-of-interest law barred B&B from entering into the legal services agreement without first obtaining Theis' informed written consent; and
- that B&B neither sought nor obtained Theis' informed written consent to B&B's conflicts of interest.

For the reasons already addressed in Theis' reply and noted in the amicus brief filed by Theis in *Buckeye*, the common issue should be examined in the context of this case as well as *Buckeye*. However, this case is not distinguishable from *Buckeye* as argued in B&B's supplemental brief.[1]

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[1] B&B claims that it filed its supplemental brief to respond to the discussion in Theis' reply concerning the relationship of this case to *Buckeye*. However, B&B's "supplemental" brief is, in effect, a second brief in opposition, attempting to answer the nullity of an arbitration award arising from an unlawful underlying agreement, the applicability of the Federal

ARGUMENT

1.a. In an attempt to sidestep the ineffectiveness of the arbitration clause in its (unlawful) legal services agreement, B&B simply disregards the record. B&B's assertion, that the purported authority of the arbitrator was not premised on the arbitration clause set forth at section 14 of B&B's legal services agreement, is erroneous.

Theis' complaint in arbitration was explicitly predicated on the arbitration clause in B&B's written legal services agreement. The complaint was addressed to B&B on January 12, 1996, nearly three years before anyone has ever contended that Theis was given any "notice" of B&B's PacTel Cellular conflict by virtue of arbitration discovery exchanged in late 1998.[2] The complaint is headed:

> Re: Demand for arbitration under § 14 of the legal services agreement between Theis Research, Inc. and Brown & Bain dated October 30, 1992 and August 20, 1993.[3]

Arbitration Act, and the void vs. voidable distinction—all of which were discussed in the petition (starting with the first question presented). The underlying decision of the Florida Supreme Court in *Buckeye* was itself cited in Theis' petition. *Id.* at 25. B&B did not file its supplemental brief until nearly two months after Theis filed its reply—and several weeks after B&B received Theis' amicus brief in *Buckeye*.

[2] ER 7 at 17; 36 at 17. Arbitration was postponed pending an appeal in the underlying patent litigation.

[3] B&B's petition to confirm the arbitration award states that the legal services agreement was amended on August 20, 1993, to add Peter F. Theis as a party to the agreement. Record, 36 at 32 (¶ 6).

ER 7 at 17; 36 at 17. It then begins as follows:

> Peter F. Theis ("Theis") and Theis Research, Inc. ("TRI"), parties to the referenced legal services agreement dated October 30, 1992 and August 20, 1993 among TRI, Theis and Brown & Bain ("B&B"), which contains a provision for arbitration, hereby demands [*sic*] arbitration thereunder.

Id. Under the heading "**Arbitration Provision**," the complaint then quotes in full all five paragraphs of section 14 of the legal services agreement. ER 7 at 17-18.

Next, the arbitration award itself states that the arbitration occurred pursuant to the arbitration clause in the purported legal services agreement. It begins by stating:

> Pursuant to ¶14 of an Agreement for legal services dated October 30, 1992 and August 20, 1993, Peter F. Theis and Theis Research, Incorporated ("TRI") and Brown & Bain, P.A. ("B&B") have agreed to submit certain disputes to arbitration.

ER 13 at 6. *Accord* ER 13 at 8 (same purported authority recited in arbitrator's statement of reasons).

Further, even B&B's own petition to confirm the arbitration award is premised on the authority purportedly conferred by the arbitration clause:

> On October 30, 1992, Brown & Bain and [Theis] entered into a legal services agreement (the "Agreement") under which Brown & Bain agreed to represent [Theis] in

> certain litigation. Paragraph 14 of the Agreement provided for the arbitration of any and all disputes arising under the Agreement.

Record, 36 at 31 (¶ 5); *see also id.* at 34-45 (attached copy of legal services agreement).

Moreover, in its appellee's brief to the Ninth Circuit, B&B acknowledged that Theis presented its claims against B&B "pursuant to an arbitration clause in their Representation Agreement . . .." Appellee's br. at 5.

In sum, the record establishes unequivocally that the arbitration award was premised on the arbitration clause embedded in the putative legal services agreement.

1.b. B&B argues that—"regardless of whether the legal services agreement was void, voidable, or fully enforceable"—the arbitrator's authority could instead be predicated on an unwritten, implied "consent" to arbitration through participation (even though induced by a putative, but in fact unlawful, underlying agreement). This argument is not only against the record, it is contrary to authority.

The Federal Arbitration Act flatly forecloses B&B's argument. Under the FAA's express terms, an arbitrator's authority must be predicated on a "written" provision or an agreement that is "in writing." 9 U.S.C. § 2. California arbitration law is also predicated on a "written" agreement. Cal. Code Civ. Proc. § 1281. *See* pet. at 27 n.41.[4]

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[4] The Ninth Circuit's decision is even premised on Theis' having asserted in arbitration its challenge to the legal services agreement as void *ab initio*. App., 13a. The petition (at 7-14) contrasts the record with the Ninth Circuit's decision.

B&B cites two Ninth Circuit decisions, *Ficek v. Southern Pacific Co.*, 338 F.2d 655 (9th Cir. 1964), and *Nghiem v. NEC Electronic, Inc.*, 25 F.3d 1437 (9th Cir. 1994), but both are inapposite. In both *Ficek* and *Nghiem*, the Ninth Circuit did not purport to apply any rule of law derived from either the Federal Arbitration Act or state law, but rules derived from federal labor law.[5]

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[5] *Ficek* concerned the scope of an arbitration clause in a collective bargaining agreement. 338 F.2d at 656-657. No question was raised as to the validity of the written collective bargaining agreement or its arbitration clause. The question was whether the disputed issue fell within the scope of the clause, and the court found that it did. *Id.*

Nghiem involved an employment dispute. The court found that a written arbitration provision in an employer's policies constituted a written agreement though not signed by the employee. 25 F.3d at 1439-1440. The court also asserted that proceeding with arbitration implied an agreement, but for this theory it relied entirely on three labor cases. *Id.* at 1440 (citing *Piggly Wiggly Operators' Warehouse, Inc. v. Piggly Wiggly etc. Truck Drivers Union, Local No. 1*, 611 F.2d 580 (5th Cir. 1980); *Fortune, Alsweet & Eldridge, Inc. v. Daniel*, 724 F.2d 1355 (9th Cir. 1983); *Teamsters Local Union No. 764 v. J.H. Merritt and Co.*, 770 F.2d 40 (3d Cir. 1985)). Although the appellant invoked the FAA, the Ninth Circuit did not. *Id.* at 1439-1440.

Furthermore, even under *Nghiem*, the scope of implied arbitral authority is limited to the precise issue submitted. *Id.* at 1440. Thus, even accepting the Ninth Circuit's assertion that B&B's conflicts of interest were raised in a challenge to the legal services agreement as void *ab initio* (*see* n.5, *supra*), consent to arbitration under the putative agreement cannot by implied when it is under challenge.

Federal common law governing arbitrations to resolve labor relations disputes provides no authority controlling in either this case or *Buckeye*.[6] B&B did not purport to render legal services pursuant to a putative collective bargaining agreement.

2. B&B advances the extraordinary and unsupported argument that this case does not concern the Federal Arbitration Act (FAA), suggesting that this Court is powerless to review the Ninth Circuit's decision below.[7] B&B cites the incorporation of California law in the putative legal services agreement.[8] Application of the FAA and state law to arbitration questions, however, is not mutually exclusive. *See, e.g., First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995); *Rosenthal v. Great Western Financial Securities Corp.*, 14 Cal. 4th 394, 416 (1996).

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[6] *Cf. Allis-Chalmers Corp. v. Lueck*, 471 U.S. 202, 209 (1985) (§ 301 of the Labor Management Relations Act of 1947, 29 U.S.C. § 185, is "a congressional mandate to the federal courts to fashion a body of federal common law to be used to address disputes arising out of labor contracts"); *Textile Workers Union of America v. Lincoln Mills*, 353 U.S. 448, 456-457 (1957).

[7] Even under B&B's new erroneous theory, the Ninth Circuit's refusal to apply California law by itself presents a federal question under the Rules of Decision Act, 28 U.S.C. § 1652.

[8] B&B also cites the reference to procedural rules of the American Arbitration Association (AAA). Notwithstanding B&B's assertion that AAA procedural rules controlled, the reference to such rules in the arbitration clause was only supplemental and subject to a number of other specific provisions (concerning arbitrator selection, prohibition against ex parte contact, discovery, evidence, and expedited proceedings). ER 7 at 18; 41 at 52.

Applicability of the FAA does not depend on the express incorporation of the FAA in the text of an arbitration clause. This Court has already declared the broad reach of the FAA. *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52, 56 (2003)(FAA encompasses "'the full reach of the Commerce Clause'").[9]

B&B's argument is novel, even among its own contentions in this litigation. B&B invoked the FAA in the very title of its "Petition for Confirmation of Arbitration Award (9 U.S.C. § 9)." Record, 36 at 31. B&B expressly based its motion to confirm the award on the provisions of the FAA. Record, 35 at 1-9 (every single page of B&B's motion to confirm cites at least one section of the FAA).

If the Ninth Circuit's decision in this case were not subject to resolution through interpretation of the FAA, then there is no governing law at all under which the Ninth Circuit could have purportedly made its decision. The Ninth Circuit certainly did not purport to make its decision under California law.

3. The district court erred by failing to vacate the arbitration award, which arose from an underlying agreement that was an unlawful—and therefore void

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[9] The applicability of the FAA as a matter of law to an arbitration clause subject to contractual incorporation of both state law and AAA procedures was illustrated in a recent California decision. *Hotels Nevada, LLC v. Bridge Banc, LLC*, 130 Cal. App. 4th 1431 (2005). Affirming an order denying a petition to compel arbitration, the court held that an arbitrator properly deferred for judicial determination a question of whether the underlying agreement was unlawful—thus voiding the purported contract and the embedded arbitration clause—and that this was proper under the FAA. *Id.* at 1433.

ab initio—under state law. The Ninth Circuit failed to correct the district court's error of law, not even addressing the district court's erroneous assertion that the unlawful legal services agreement was "voidable, not void." A favorable determination by this Court of either of the first two questions presented by the petition would—at a minimum—be a sufficient basis to remand to the Ninth Circuit for consideration of whether the district court's assertion was error, although the error is obvious upon any plain reading of California law.

The district court refused to apply the plain language set forth in California precedents vacating arbitration awards arising out contracts entered into illegally by an unlicensed contractor and by an unlicensed broker.[10]

Instead, without any authority, the district court created a Lawyers Exception in conflict with California law.

Under California law, an agreement in violation of the Rules of Professional Conduct is unlawful and unenforceable. *Kallen v. Delug*, 157 Cal. App. 3d 940, 948-949, 951 (1984). "[A]n illegal contract is void . . . " (*id.* at 948, n.2)—not merely voidable.

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[10] *Loving & Evans v. Blick*, 33 Cal.2d 603, 610-612 (1949); *All Points Traders, Inc. v. Barrington Associates*, 211 Cal.App.3d 723, 738 (1989).

The California Rules of Professional Conduct that barred B&B's representation of Theis stand on just as strong a legal footing as the broker and contractor licensing requirements. *See Chambers v. Kay*, 29 Cal. 4th 142, 158 (2002)(conduct rules "'protect the public . . . '"; giving effect to a purported agreement violating the rules "would be untenable . . . ").

An unlawful representation, undertaken in violation of the rules, cannot be converted retroactively into a lawful representation. Informed written consent to a conflicting representation is a precondition to proceeding with a representation in compliance with the rules. Cal. R. Prof. Conduct 3-310(C)(3). The district court, however, attempted to mutate the provision for informed written consent into a possibility for an after-the-fact waiver of the violation of the rules against conflicts of interest, and from there asserted that an agreement in violation of the rules was "voidable, not void." Furthermore, the district court premised such "waiver" on implication—without any written consent purportedly satisfying the rules.

Soon after the district court's judgment, the California Supreme Court held that where the Rules of Professional Conduct require informed written consent, such consent cannot be given in any other way. *Chambers v. Kay*, 29 Cal. 4th at 155-156. The California Supreme Court also foreclosed any argument that such consent could be inferred from a purported waiver. In *Chambers*, lawyers jointly representing a client entered into a fee-splitting agreement without obtaining the requisite informed written consent of their client. The California Supreme Court rejected a nearly identical attempt to confuse "waiver" with "consent." Even though the client did not object after being provided a copy of a writing memorializing the purported agreement, the California Supreme Court held this could not satisfy the rule requirement of informed written consent by the client. *Id.* at 146, 155-156, 158. The Ninth Circuit decided not to address this. *Cf.* 9th Cir. appellant's br. at 3, 33-35, 45, & reply br. at 1-2, 15-16.

As noted in the reply, although informed written consent—if given in the midst of a conflicted representation—might legitimize the representation going

forward, it cannot change the fact that the representation up to that point was unlawful and therefore void. There is a distinction between (a) *ex ante* informed written consent—which Cal. R. Prof. Conduct 3-310(C) permits, and (b) *ex post facto* waiver of an unlawful contract—which California law does *not* permit. *City Lincoln-Mercury Co. v. Lindsey*, 52 Cal. 2d 267, 274 (1959); *International Assn. of Fire Fighters v. City of San Leandro*, 181 Cal. App. 3d 179, 182 (1986). Moreover, there is no dispute that Theis never gave any informed written consent to B&B's conflicts of interest.

CONCLUSION

This case is not distinguishable from *Buckeye* as argued by B&B.

Theis requests that the petition be granted for plenary review at this time. In the alternative, Theis requests grant and hold pending the Court's decision in *Buckeye*.

Respectfully submitted,

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Respondent.

On Petition for a Writ of Certiorari
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PETITIONER'S 2nd SUPPLEMENTAL BRIEF

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Rule 29.6 Statement: As stated in the petition, there is no parent or publicly held company owning 10% or more of the stock of petitioner Theis Research, Inc.

TABLE OF AUTHORITIES

Cases

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400 F.3d 659 (9th Cir. 2005) 3

Statute

9 U.S.C. § 10 3

Petitioner Theis Research, Inc. (Theis) submits this second supplemental brief in light of the Court's decision on February 21, 2006, in *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. ___ (2006)(No. 04-1264). Two issues unresolved in *Buckeye* are ripe for determination here.

The first issue is whether courts or arbitrators decide if the parties had the authority and the capacity to enter into the underlying agreement. *See Buckeye*, slip op. at 3 n.1. In this case, under applicable state law, respondent law firm Brown & Bain had no lawful authority or capacity to enter into *any* legal services agreement to represent Theis in the underlying litigation, given the firm's conflicts of interest and its failure to obtain Theis' informed written consent.

The second issue is whether courts have authority, *after* a matter has been arbitrated, to address illegality and invalidity of an underlying putative contract that has an embedded arbitration clause.

The combined effect of the Court's decision in *Buckeye* and the Ninth Circuit's decision in this case—unless this Court reverses the Ninth Circuit's decision—is that courts will *never* be permitted to review the illegality of an underlying agreement. Unlike *Buckeye*, this case arises post-arbitration. The Ninth Circuit concluded that once an arbitrator decides the validity of the underlying agreement, the issue is not open for judicial determination.

As discussed in Theis' amicus brief in support of neither party in *Buckeye*, even if a party must first go to arbitration, a party is entitled to have its illegality challenge to a putative contract decided finally—at some point—by a court rather than an arbitrator. Otherwise, if courts ignore illegality and confirm awards arising from unlawful agreements, courts would become the silent partners of

those who would misuse arbitration to perpetrate unlawful conduct through illegal contracts.

The petitioner in *Buckeye* asserted in its answering brief to the Florida Supreme Court that post-arbitration determination of illegality by a court reviewing an arbitration award would assure against the misuse of arbitration to perpetrate unlawful conduct. Buckeye Check Cashing, Inc. cited the Ninth Circuit's first decision in *Theis Research, Inc. v. Brown & Bain*, arguing that:

> The simple answer to [respondents Cardegna and Reuter's] imaginative hypothetical concerning a contract to purchase and sell drugs that contained an arbitration provision, [br. citation], is that assuming there is no specific attack on the making of the arbitration agreement, the dispute would be directed to arbitration. Presumably, no arbitrator would enforce the underlying contract, but even if he or she did, a court would not enforce the arbitrator's award. *See, e.g., Theis Research, Inc. v. Brown & Bain*, 240 F.3d 795, 796 (9th Cir. 2001) ("TRI's assertions that the arbitration award was invalid because it was based on an illegal contract are properly resolved in the context of TRI's motion to vacate the award.").

Buckeye's *Answer Br.* to Fla. S. Ct. at 17 n.2.

In its current decision, however, the Ninth Circuit has reversed course, holding (erroneously) that presenting the illegality challenge to an arbitrator bars courts from thereafter deciding the issue.

> **Theis submitted to the arbitrator the issue whether B&B's alleged conflicts of interest rendered the Theis-B&B legal services agreement void *ab initio*. The arbitrator rendered a decision on this issue adverse to Theis. The district court thus did not err when it determined that Theis was barred from relitigating the same issue as part of its federal court malpractice claims.**

Theis Research, Inc. v. Brown & Bain, 400 F.3d 659, 666 (9th Cir. 2005). The court's judgment should be reversed.

Contrary to the Ninth Circuit's opinion, this Court's decision in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 946-947 (1995), indicates that arguing an issue of arbitrability to an arbitrator is not an obstacle to subsequent judicial determination of the issue.

The validity of an underlying agreement with an arbitration clause concerns the authority of the arbitrator and, therefore, should be decided *de novo* by a court upon application to vacate an award. The Federal Arbitration Act requires that courts vacate *ultra vires* awards—"where the arbitrators exceeded their powers, ..." 9 U.S.C. § 10.

Theis respectfully requests that its petition for a writ of certiorari be granted for plenary review.

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